Supreme Court, U.S.
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In The
Supreme Court of the United States

GEORGE W. SYDNOR, JR. and THE MCGRAW GROUP, INCORPORATED,

Petitioners,

v.

N. GLENN SMITH, For himself and all Plan Participants similarly situated on behalf of the James McGraw, Inc., 401(k) Plan,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Petition for Writ of Certiorari

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QUESTION PRESENTED

Whether a claim to recover benefits under a 401(k) plan, alleging a breach of fiduciary duties by the trustee under the Employee Retirement Income Security Act of 1974 ("ERISA"), requires prior exhaustion of the plan's administrative remedies?

DISCLOSURE STATEMENT PURSUANT TO RULE 29.6

Petitioner The McGraw Group, Inc. makes the following disclosures pursuant to this Court's Rule 29.6:

1. No company holds the interests of The McGraw Group, Inc., a Virginia corporation.

2. The McGraw Group, Inc. owns 100% of S&K/Air Power Tool and Supply Corp., a Delaware corporation, which owns S & K/ Air Power Leasing, Inc., an Illinois corporation.

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Petitioners, The McGraw Group, Inc. ("McGraw") and George W. Sydnor, Jr. ("Sydnor"), hereby petition for a writ of certiorari to review the decision of the United States Court of Appeals for the Fourth Circuit which reversed the decision of the United States District Court for the Eastern District of Virginia, Richmond Division.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 184 F.3d 356 (4th Cir. 1999) and is included in the Appendix at 1. The order and memorandum opinion of the district court is unreported and included in the Appendix at 20.

JURISDICTION

The opinion of the Court of Appeals was issued on July 9, 1999. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The statutory provisions involved are 28 U.S.C. § 1254(1), 29 U.S.C. § 1001, 29 U.S.C. § 1109, 29 U.S.C. § 1133 and 29 C.F.R. § 2560.503-1, included in the Appendix at page 24-34.

STATEMENT OF THE CASE

N. Glenn Smith ("Smith") terminated his employment with McGraw in December of 1997. On February 16, 1998, Smith submitted his request for distribution of benefits from the McGraw retirement plan and, consistent with his election, received a cash distribution in March of 1998 representing the value of his 401(k) account. Smith was dissatisfied with the amount of his distribution and on April 22, 1998, brought suit against

Sydnor, as trustee of the 401(k) plan, and McGraw, as Sydnor's co-fiduciary. Counts One and Two of the First Amended Complaint, which frame the issues to be litigated in this action, assert that Sydnor and McGraw breached their fiduciary duties as trustees for the 401(k) plan by, inter alia, selling shares of preferred stock held by the plan in an ESOP trust at a grossly undervalued price.[1] Smith sought to recover the difference between $70 per share (the price that was used to calculate the amount of the cash distribution he received) and $260.31 per share (the price that Smith alleged was appropriate), for the 58 shares of preferred stock allocated to Smith's account in the plan. (A. 22).

On July 21, 1998, the U.S. District Court for the Eastern District of Virginia granted defendants' motion to dismiss Smith's First Amended Complaint and directed Smith to avail himself of the administrative review procedures set forth in the plan before bringing suit. The court concluded that "the fact that a plaintiff may state a claim for breach of fiduciary duty does not remove the exhaustion requirement when the claim is, in essence, a denial of benefit claim." (A. 22). On July 9, 1999, the U.S. Court of Appeals for the Fourth Circuit reversed and remanded the case to the district court. While the Fourth Circuit determined that the remedy sought by Smith will "undoubtedly benefit" him, it held that the exhaustion requirement does not apply to a claim alleging breach of fiduciary duty by plan trustees.

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[1] Effective January 1, 1993, McGraw converted the ESOP into the 401(k) plan. McGraw's amended and restated Articles of Incorporation provided that plan participants who held preferred stock pursuant to a distribution from the ESOP could require their stock be redeemed at a price of $260.31 per share. McGraw purchased the stock for $70.00 per share. (A. 21).

REASONS FOR GRANTING THE WRIT

I. THE FOURTH CIRCUIT JOINS THE MINORITY OF CIRCUITS ON THE WRONG SIDE OF THE EXISTING SPLIT OF AUTHORITY

The Fourth Circuit's erroneous decision further contributes to the existing split among the Circuits on the issue of whether a plaintiff must exhaust administrative remedies provided by an ERISA-regulated plan where he alleges a violation of ERISA. The Fourth Circuit acknowledged that "[the courts of appeal] are in sharp disagreement as to whether a plaintiff must exhaust administrative remedies required before a plaintiff can bring an ERISA action in federal court to assert a violation of an ERISA statutory provision, such as a claim for breach of fiduciary duty." (A. 15). Unfortunately, the Fourth Circuit joins the minority of the Circuits (namely, the Third, Ninth, and Tenth Circuits) on the wrong side of this divide. The minority holds that a plaintiff need not exhaust administrative remedies before bringing suit for an alleged statutory violation, including breach of fiduciary duty.[2] In contrast, the majority of the Circuits (the First, Second, Fifth, Sixth, Seventh, and Eleventh Circuits) require a plaintiff to exhaust administrative remedies even where the complaint alleges statutory violations, including fiduciary breaches.[3]

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[2] See e.g. Zipf v. American Tel. and Tel. Co., 799 F.2d 889 (3d Cir. 1986); Amaro v. Continental Can Co., 724 F.2d 747 (9th Cir. 1984); Held v. Manufacturers Hanover Leasing Corp., 912 F.2d 1197 (10th Cir. 1990).

[3] See e.g. Drinkwater v. Metro. Life Ins. Co., 846 F.2d 821 (1st Cir. 1988); Alfarone v. Bernie Wolff Construction Corp., 788 F.2d 76 (2d Cir. 1986); Simmons v. Wilcox, 911 F.2d 1077 (5th Cir. 1990); Constantino v. TRW, Inc., 13 F.3d 969 (6th Cir. 1994); Lindemann v. Mobil Oil Corp., 79 F.3d 647 (7th Cir. 1996); Mason v. Continental

The rationale of the majority is more sound and has at least three important advantages over the minority approach.

First, the majority position does not depend on a formalistic characterization of the plaintiff's claim as one for breach of fiduciary duty versus one for recovery of plan benefits. It requires administrative exhaustion irrespective of the label applied to the cause of action so long as the plaintiff pursues recovery of plan benefits. These courts logically reason that any improper denial of benefits could constitute a breach of fiduciary duty, but focus instead on whether the relief sought is the recovery of benefits under the plan. Thus, the majority rule makes it impossible to frustrate the exhaustion requirement by means of artful pleading and assures that the purposes of administrative exhaustion will be furthered in a uniform and predictable way for the benefit of all employees irrespective of the drafting skills of their counsel. As noted by the Second Circuit, if the courts allow "claimants to play this characterization game, then the exhaustion requirement would be rendered meaningless." Drinkwater, 846 F.2d at 826. See also Simmons, 911 F.2d at 1081[4].

Second, in contrast to the minority approach, the majority approach furthers all of the goals inherent in the exhaustion requirement in the interests of participants in ERISA-regulated plans. See, e.g., Constantino, 13 F.3d at 975, citing Makar v. Health Care Corp. of Mid-Atlantic, 872 F.2d 80, 83 (4th Cir. 1989) ("(1) To help reduce the number of frivoulous law-suits under ERISA. (2) To promote the consistent treatment of claims for benefits. (3) To provide a

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Group, Inc., 763 F.2d 1219 (11th Cir. 1985), cert. denied, 474 U.S. 1087 (1986).

[4] "[A]ny improper denial of benefits also constitutes a breach of fiduciary duty under ERISA, the court concluded that the exhaustion requirement would be rendered meaningless if plaintiffs could avoid it simply by recharacterizing their claims for benefits as claims for breach of fiduciary duty." Simmons, 911 F.2d at 1081.

nonadversarial method of claims settlement. (4) To minimize the costs of claims settlement for all concerned. (5) To enhance the ability of trustees of benefit plans to expertly and efficiently manage their funds by preventing premature judicial intervention in their decision-making processes. (6) To enhance the ability of trustees of benefit plans to correct their errors. (7) To enhance the ability of trustees of benefit plans to interpret plan provisions. (8) To help assemble a factual record which will assist a court in reviewing the fiduciaries' actions.") Notwithstanding the nature of the violation, exhaustion would further important goals such as promoting the consistent treatment of claims for benefits, providing a non-adversarial method of claims settlement, minimizing the costs of claims settlement, and assisting in assembling a factual record which would be helpful in reviewing the fiduciaries' actions.[5]

Third, the majority rule is consistent with the policies underlying ERISA's requirement of internal claims procedures. See Lindemann, 79 F.3d at 650 ("Congress's apparent intent in mandating internal claims procedures found in ERISA was to minimize the number of frivoulous lawsuits, promote a non-adversarial dispute resolution process, and decrease the cost and time of claims settlement. . . . [E]xhaustion 'supports the important public policy of encouraging private rather than judicial resolution of disputes under ERISA.'") (citations omitted). See also

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[5] See Constantino, 13 F.3d at 975 ("If these purposes would not be furthered, there would be no sense in exhausting administrative remedies."). Discussing the important functions served by the exhaustion requirement, the Seventh Circuit stated that "an administrator's interpretation of a plan is not the only useful function served by the exhaustion requirement . . . These functions are served whether the plaintiff structures her claim to seek the actual benefits . . . or to seek other remedies . . ." Lindemann, 79 F.3d at 650. See also Fallick v. Nationwide Mut. Ins. Co., 957 F. Supp. 1442, 1455 (S.D. Ohio 1997), rev'd on other grounds, 162 F.3d 410 (6th Cir. 1998).

Springer v. Wal-Mart Associates' Group Health Plan, 908 F.2d 897, 900 (11th Cir. 1990) ("[A] strong policy favoring . . . exhaustion underlies the statutory scheme."); Mason, 763 F.2d at 1227 ([I]mposing an exhaustion requirement in the ERISA context appears to be consistent with the intent of Congress . . . ").[6]

The Fourth Circuit's decision and those of the minority Circuits directly contradict the important goals of a dispute-resolution mechanism required by ERISA. They discourage and make more difficult a non-adversarial resolution of the present dispute, and will inevitably result in a substantial increase, rather than decrease, of the cost and time of any potential resolution of the claim in question.[7]

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[6] This is consistent with one of the main purposes of ERISA, namely, to make the mechanism of the benefits recovery accessible and affordable for the employees. See 29 U.S.C. § 1001(a). See also Lindemann, 79 F.3d at 647; Kross v. Western Elec. Co., 701 F.2d 1238, 1244 (7th Cir. 1983); 29 U.S.C. § 1133(2). Thus, one of the important advantages of ERISA is that it eliminates, in many instances, a need for an employee to bring a case in court. See Challenger v. Local Union No.1 of Intern. Bridge, 619 F.2d 645, 649 (7th Cir. 1980) ("To make every claim dispute into a federal case would undermine the claim procedure contemplated by the Act. It would also burden employee benefit funds with substantial expense. We believe that Congress, in adopting ERISA, did not require or contemplate such a result.") (citations omitted).

[7] See, e.g., Mason, 763 F.2d at 1227 ("Compelling considerations exist for plaintiffs to exhaust administrative remedies prior to instituting a lawsuit. Administrative claim-resolution procedures . . . minimize the cost of dispute resolution . . . by preventing premature judicial intervention in the decision making process . . . ").

II. THE FOURTH CIRCUIT'S DECISION CONFLICTS WITH THE POSITION OF THE REMAINING CIRCUITS AND CREATES A NEW SPLIT OF AUTHORITY ON THE EXHAUSTION RULE

The decision whether to apply the exhaustion requirement "is committed to the district court's sound discretion and can be overturned on appeal only if the district court has clearly abused its discretion." Curry v. Contract Fabricators Inc. Profit Sharing Plan , 891 F.2d 842, 846 (11th Cir. 1990). The district court below found that, although Smith "alleges the defendants breached their fiduciary duty, he is in fact claiming that he is owed the $260.31 per share plus interest that is discussed in the Articles of Incorporation. The fact that a plaintiff may state a claim for breach of fiduciary duty does not remove the exhaustion requirement when the claim is, in essence, a denial of benefit claim." (A. 22).[8] On appeal, the Fourth Circuit took an "either-or" approach: either a plaintiff alleges "valid claims for breach of fiduciary duties defined in §§ 404-406 of ERISA," and consequently need not exhaust

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[8] Counts I and II of the First Amended Complaint allege breaches of fiduciary duties by McGraw and Sydnor. As a remedy, Smith seeks to recover money damages on behalf of himself and other members of a putative class of plan participants. However, the redress Smith is seeking proves only that his claim is brought to recover allegedly denied benefits rather than to remedy an alleged breach of fiduciary duty. A redress for breach of fiduciary duty provided under ERISA is "to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary . . ." Such redress provides no damages to an individual plaintiff or to a class of plaintiffs. 29 U.S.C. § 1109(a). See also Horan v. Kaiser Steel Retirement Plan, 947 F.2d 1412, 1417-18 (9th Cir. 1991) ("An individual beneficiary may bring a fiduciary breach claim, but must do so for the benefit of the plan."), citing Massachusetts Mutual Life Ins. v. Russell, 473 U.S. 134, 144 (1985).

administrative remedies, or the plaintiff alleges a denial of benefits, and therefore is subject to the exhaustion requirement. (A. at 19). In this manner, the Fourth Circuit elevated form over substance and blinded itself to the essential nature of Smith's claim.

The assertion of claims for recovery of plan benefits premised upon allegations supporting claims for breach of fiduciary duties is not unique to this case. Other courts, when confronted with such claims, have properly required exhaustion of administrative remedies. See Fallick, 957 F. Supp. at 1457 ("The mere fact that the same conduct resulting in an alleged deprivation of benefits can also be, for example, the basis for a claim of breach of fiduciary duty ... does not mean that administrative exhaustion does not apply.").[9] See also Zipf, 799 F.2d at 889, n. 6 ("We acknowledge that cases may arise in which a Section 510 claim is so closely intertwined with a serious issue requiring interpretation of a benefit plan that a trial court could properly stay the statutory action pending resolution of the issue by the plan fiduciaries."). Furthermore, the judicial determination of whether the action is essentially brought to recover benefits under the plan should not be based exclusively on the language of the allegations in the complaint. Rather, it should be based on the substance of the

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[9] The Fourth Circuit mistakenly premised its decision on the fact that a recovery sought by the plaintiff would benefit not only him, but the plan as well. However, the exhaustion requirement is not limited to cases where the employee seeks to recover a benefit solely for himself. Such a restriction has been invented by the Fourth Circuit and has no support either in statute or in the case law. Thus, claims procedures under ERISA should "afford a reasonable opportunity to any participant whose claim for benefits has been denied for a full and fair review by the appropriate named fiduciary of the decision denying the claim." 29 U.S.C. § 1133(2). The statute does not place a condition that the plan as a whole should not benefit from the remedy sought by the individual claimant in order to apply internal administrative procedures.

claims.[10] As the Third Circuit stated,

> Section 502(a) of ERISA does not require either issue or theory exhaustion; it requires only claim exhaustion . . . . [J]urisdictional inquiry should not be focused on the theory on which the district court decided plaintiff's claim. Instead, the focus of our inquiry must be whether the plaintiff exhausted her internal union remedies.

Wolf v. National Shopmen Pension Fund, 728 F.2d 182, 186 (3d Cir. 1984). The Fourth Circuit determined that Smith would undoubtedly recover a benefit as a result of prevailing on his claim for an alleged breach of fiduciary duty by the plan trustees. As such, regardless of the captions applied to the claims in his pleadings, his claim is properly construed as one to recover benefits under his ERISA-regulated plan.

As the Eleventh Circuit stated, "[t]he very premise of the exhaustion requirement . . . is that the right to seek federal court review matures only after that requirement has been appropriately satisfied or otherwise excused." Springer, 908 F.2d at 900. Any rule or interpretation that may create a conflict and collide with the exhaustion requirement must yield as secondary and subordinate. The general rule "is that the exhaustion requirement 'may be waived in only the most exceptional circumstances.'" Communications Workers of Am. v. American Tel.and Tel. Co., 40 F.3d 426, 432 (D.C. Cir. 1994) (citations omitted).[11]

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[10] The statute provides as follows: "Filing of a claim for benefits. For purposes of this section, a claim is a request for a plan benefit by a participant or beneficiary." 29 C.F.R. § 2560.503-1(d) (emphasis added).

[11] See Amato v. Bernard, 618 F.2d 559, 567-68 (9th Cir. 1980) ("It would certainly be anomalous if the same good reasons that presumably led Congress and the Secretary to require covered plans to provide administrative remedies for aggrieved claimants did not lead the courts to

There are only two exceptions to the general exhaustion requirement: (1) where it would be futile to require the plaintiff to exhaust plan remedies; or (2) where the employee has been or will be wrongfully denied meaningful access to internal administrative procedures. Neither of these exceptions was found to apply in the instant case.

These two exceptions to the exhaustion requirement are grounded in the policies underlying ERISA's requirement that employees have access to an affordable and meaningful mechanism of recovering their benefits vested under an ERISA plan. Fallick v. Nationwide Mut. Ins. Co., 162 F.3d 410, 419 (6th Cir. 1998). See also Diaz v. United Agr. Employee Welfare Benefit Plan, 50 F.3d 1478 (9th Cir. 1995). Neither exception depends upon the nature of the alleged violation that caused an employee to seek recovery of his or her benefits (e.g., whether any breach of a fiduciary duty was alleged as opposed to an administrative error).

As support for its holding that a claim for a violation of ERISA by plan fiduciaries is not subject to the exhaustion requirement, the Fourth Circuit cited Zipf and Amaro (A. 17).[12] However, the Fourth Circuit's reliance on these cases is misplaced. They do not stand for the broad proposition that administrative exhaustion is not required for any claim involving alleged violations of ERISA. Discussing this same

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see that those remedies are regularly used.... In sum, we conclude that the federal courts have the authority to enforce the exhaustion requirement in suits under ERISA, and that as a matter of sound policy they should usually do so.") (citations omitted) (emphasis added). See also Kross, 701 F.2d at 1245.

[12] See Zipf, 799 F.2d at 891 ("We decline [appellee's] invitation to find in ERISA an implied exhaustion requirement applicable to substantive rights conferred by that Act."). See also Amaro, 724 F.2d at 751 ("We are faced solely with an alleged violation of a protection afforded by ERISA. There is no internal appeal procedure either mandated or recommended by ERISA to hear these claims.").

line of cases, the court in Fallick correctly observed that they "stand simply for the proposition that exhaustion should not be required where there is nothing at issue but a question of statutory interpretation in an action alleging the deprivation of a statutory protected right under ERISA." Fallick, 957 F.Supp. at 1457.[13] In contrast, Smith seeks to recover a benefit that was allegedly denied him and others through the breach of fiduciary duty. Consequently, "this is not a case where all that is required is the interpretation of a section of ERISA." Id. Accordingly, a completely different part of the rationale employed by the courts in Zipf and Amaro is applicable. See, e.g., Amaro, 724 F.2d at 751 ("We construe this argument to address the situation where the same essential facts give rise to both a section 510 claim and a contractual grievance." (emphasis added) (referring to a situation in which the exhaustion requirement would apply)). For this reason, no precedent supports the Fourth Circuit's decision. The Fourth Circuit stands alone against the rest of the Circuits in holding that the allegation of a breach of fiduciary duties by 401(k) plan trustees can remove a claim for recovery of benefits from the scope of the exhaustion requirement.

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[13] See Unger v. U.S. West, Inc., 889 F. Supp. 419 (D. Colo. 1995), involving a claim for breach of fiduciary duty unaccompanied by any claim for benefits.

III. ERISA REQUIRES EXHAUSTION OF ADMINISTRATIVE REMEDIES IN ACTIONS BROUGHT TO RECOVER PLAN BENEFITS AND COMPELS REVERSAL OF THE FOURTH CIRCUIT'S DECISION

Reversal of the Fourth Circuit's order would harmonize both the existing split among the Circuits and would eliminate the new split created by the Fourth Circuit. Where a claimant will receive an immediate and direct financial benefit as a result of a favorable resolution of his claim, the claimant should be required to exhaust administrative remedies under the ERISA-regulated plan before he is allowed to file a claim in court, regardless of the characterization of the cause of action on which the claim is based. On the other hand, if a claimant seeks redress for an alleged violation of ERISA where he will not directly benefit financially as a result of a resolution of his claim, such claim would not be subject to the exhaustion requirement. Such interpretation of the general exhaustion requirement is consistent with the public policy behind ERISA.

The Supreme Court has previously considered a petition for certiorari on the issue of whether beneficiaries of an ERISA plan must exhaust internal plan remedies before suing plan fiduciaries on the basis of an alleged violation of duties imposed by the statute. Mason v. Continental Group, Inc., 474 U.S. 1087 (1986). While this Court denied certiorari, Justice White noted in his dissent

> The increasing significance of ERISA litigation is apparent from the growing number of such cases that appear on our docket; in a field so productive of federal litigation, the need for clear procedural rules governing access to the federal courts is imperative. Moreover, because the coverage of particular ERISA plans frequently extends

> to beneficiaries in more than one State – and, no doubt, in more than one judicial circuit – differences in the rules governing access to federal court for the purpose of pressing a claim under ERISA may have the troubling effect of encouraging forum shopping by plaintiffs. Accordingly, the conflict among the Circuits over the issue of an exhaustion requirement under ERISA can hardly be passed over as an unimportant one unworthy of this Court's attention.

Id., at 1087-1088 (White, J., dissenting). Justice White's prediction has proven true. Since 1986, when this Court passed on an opportunity to address the issue, the split has become wider and deeper.[14] This split will not be resolved at the circuit level, because the divergent theories chosen by the courts of appeal cannot be reconciled in the absence of clear and explicit guidance from this Court.

As time progresses, the need for guidance on this issue will only increase. The longest uninterrupted period of economic growth in the nation's history has substantially boosted employment and, accordingly, the number of employees. At the same time, life expectancy has also substantially increased. These two factors provide a steady increase in the number of retiring employees and a corresponding increase in the importance of uniform and

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[14] In his dissenting opinion, Justice White referred to a split involving three Circuits: the Third, the Seventh, and the Ninth Circuits. Since then, more Circuits have been added to this split, and in its opinion the Fourth Circuit referenced opinions of the Third, Fifth, Sixth, Seventh, Ninth, and Eleventh Circuits as involved in the split. This list now includes the Fourth Circuit as well. Accordingly, the entire federal system stands divided on the issue. Justice White's reasoning has grown more compelling with the widening split and the lack of guidance for the Circuits.

consistent implementation of ERISA's provisions. [15]

The issue of exhaustion as related to claims for denied benefits under ERISA-regulated plans desperately needs the Supreme Court's consideration. The Fourth Circuit's decision to join the minority of Circuits that hold that administrative exhaustion is not required where a violation of ERISA is alleged impedes the overarching goal of efficient resolution of ERISA-based claims. In order to adequately protect the rights granted under ERISA to employees with regard to their retirement benefits and in furtherance of the public policies promoted by ERISA, the decision of the Fourth Circuit should be reversed.

CONCLUSION

The Fourth Circuit held that the exhaustion requirement does not apply to a claim brought under ERISA where such claim alleges a breach of fiduciary duty, even if the remedy sought will benefit claimant. This decision provides a new and unwarranted exception to the general exhaustion requirement of ERISA, it contributes to the existing split among the Circuits, and it creates a new one. It directly impedes the goals of Congress as expressed in ERISA, contradicts its main purposes as well as the language

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[15] This Court has recently recognized the importance of administrative exhaustion in analogous contexts. For example, it granted certiorari in Coit Independence Joint Venture v. Federal Savings and Loan Insurance Corp., 489 U.S. 561 (1989) and in Air Line Pilots Association v. Miller, 523 U.S. 866 (1998). In Coit, the Court "granted certiorari to resolve the conflict in the lower courts over whether FSLIC has exclusive authority to adjudicate the validity of creditors' state law claims against failed savings and loan associations under a FSLIC receivership." Coit, 489 U.S. at 568. In Miller, the Court granted certiorari "limited to the question whether an objector must exhaust a union-provided arbitration process before bringing an agency-fee challenge in federal court, a matter on which the Courts of Appeals have reached differing conclusions." Miller, 523 U.S. at __, 118 S.Ct. at 1764.

of the statute and its legislative history, and violates the public policy promoted by ERISA. The Fourth Circuit's decision should be reversed, and the district court's dismissal of the First Amended Complaint should be reinstated.

Dated: October 7, 1999

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PUBLISHED
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

N. GLENN SMITH, For himself and
all Plan Participants similarly
situated on behalf of the James
McGraw, Inc., 401(k) Plan,
Plaintiff-Appellant,

98-2235

v.

GEORGE SYDNOR, JR.; THE MCGRAW
GROUP, INCORPORATED,
Defendants-Appellees.

Appeal from the United States District Court for the Eastern District of Virginia, at Richmond. Richard L. Williams, Senior District Judge. (CA-98-241-3)

Argued: April 6, 1999
Decided: July 9, 1999
Entered: July 9, 1999

Before NIEMEYER, WILLIAMS, and TRAXLER, Circuit Judges.

Reversed and remanded by published opinion. Judge Williams wrote the opinion, in which Judge Niemeyer and Judge Traxler joined.

COUNSEL

ARGUED: Richard K. Bennett, MCSWEENEY, BURTCH & CRUMP, P.C., Richmond, Virginia, for Appellant. Adriaen Meredith Morse, Jr., LECLAIR RYAN, P.C., Richmond, Virginia, for Appellees. **ON BRIEF:** David J.

Walton, MCSWEENEY, BURTCH & CRUMP, P.C., Richmond, Virginia, for Appellant. Stephen T. Gannon, James A. Murphy, Stephen T. Perkins, LECLAIR RYAN, P.C., Richmond, Virginia, for Appellee McGraw Group; Hugh M. Fain, III, David Shane Smith, SPOTTS, SMITH, FAIN & BUIS, P.C., Richmond, Virginia, for Appellee Sydnor.

OPINION

WILLIAMS, Circuit Judge:

N. Glenn Smith appeals the district court's Rule 12(b)(6) dismissal without prejudice of his derivative action under the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C.A. §§ 1001-1461 (West 1999). The district court concluded that although Smith's amended complaint alleged that The McGraw Group, Inc. (McGraw), [1] and its President, Chief Operating Officer, and majority stockholder, George W. Sydnor, Jr., breached their fiduciary duties with respect to a 401(k) plan administered by McGraw by engaging in imprudent and self-dealing conduct, Smith's claims were merely a recasting of a claim for benefits, which requires exhaustion of internal plan provisions before Smith could bring an action in federal court. We disagree with the district court's characterization of Smith's claims and conclude that Smith's amended complaint alleges facts that, if proven, establish breaches of fiduciary duties by McGraw and Sydnor independent of a denial of benefits. We further hold that the exhaustion requirement does not apply to a claim for breach of fiduciary duty, and, therefore, Smith was not required to avail himself of administrative remedies

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[1] In December 1997, this corporation amended its Articles of Incorporation to change its name from James McGraw, Inc. to The McGraw Group, Inc. For convenience, we refer to the corporation as McGraw throughout the opinion.

before bringing suit in federal court alleging breaches of fiduciary duties as defined by ERISA. Accordingly, we reverse the district court's dismissal of Smith's action and remand with the instruction to reinstate his amended complaint.

I.

Because this case is on appeal from a Rule 12(b)(6) dismissal, we take the following facts as alleged in Smith's amended complaint to be true. See Vickers v. Nash General Hosp., Inc., 78 F.3d 139, 141 (4th Cir. 1996). On January 1, 1989, McGraw, a corporation primarily engaged in the sale of industrial equipment and parts, established an Employee Stock Ownership Plan (ESOP) for the benefit of its employees. On December 29, 1989, McGraw filed amended and restated Articles of Incorporation to adopt a plan of reorganization. The Articles provided that preferred stock could be issued only to the ESOP or to participants in the ESOP. The Articles also stated that at any time following the earlier of December 19, 1996, or the date at which a loan agreement between McGraw and the ESOP was satisfied, plan participants who held preferred stock pursuant to a distribution from the ESOP could require their stock to be redeemed at a price of $260.31 per share. The Articles also provided that the shares of preferred stock paid cumulative dividends at the rate of eight percent of the par value per year.

Effective January 1, 1993, McGraw converted the ESOP into the 401(k) Savings Plan & Trust (the 401(k) Plan). At all relevant times, George W. Sydnor, Jr. was a trustee and fiduciary with respect to the 401(k) Plan within the meaning of ERISA and was also the President and Chief Operating Officer of McGraw. Prior to September 27, 1996, Kenneth Fisketjon was the Chairman and Chief Executive Officer of McGraw and served as co-trustee of the 401(k) Plan. Prior to September 30, 1996, Sydnor and Fisketjon

each held fifty percent of the outstanding common stock in McGraw, which they purchased in December 1989 with the assistance of a large ESOP loan. Willamette Management Associates, which conducted annual appraisal reports of the ESOP preferred stock from 1990 to 1995, concluded in its 1996 draft report, which was delivered to Sydnor and McGraw in August 1996, that the fair market value of the preferred stock was $128.35 per share and that the common stock "ha[d] no residual equity value." (J.A. at 143.)

In 1996, McGraw began experiencing financial difficulties that led to discussions with Columbia Naples Capital, L.L.C. (CNC) concerning a potential investment of capital in McGraw. CNC signed a letter of intent in June 1996 to invest several million dollars in McGraw in exchange for approximately forty-five percent of the common stock. CNC, like other prospective purchasers and investors, was concerned about McGraw's obligation to repurchase the preferred stock at $260.31 per share, plus dividends. To avoid this problem, CNC proposed that McGraw redeem the preferred stock. McGraw contacted Willamette to see if it was willing to give an appraisal of the value of the preferred stock to support the transaction between CNC and McGraw. Willamette refused to give such an opinion because it would be inconsistent with its prior appraisal, which allocated all of the equity value of McGraw to the preferred stock and none to the common stock.

Undeterred by Willamette's refusal to give a positive appraisal report, on September 30, 1996, Sydnor and McGraw hired Charles Merriman of Scott & Stringfellow, Inc., to give a"fairness opinion." Merriman opined that $70.00 per share was "adequate consideration" for the purchase of the preferred stock. On the same day, Sydnor, acting on behalf of himself, the 401(k) Plan, and McGraw, consummated a series of transactions with CNC. Acting as sole trustee of the 401(k) Plan following Fisketjon's resignation as co-trustee, Sydnor accepted McGraw's "offer" to purchase the preferred stock for $70.00 per share, an

amount far less than the $260.31 value per share provided by the Articles of Incorporation plus the unpaid dividends of $104.15 per share, which totaled $364.46 value per share of preferred stock. This price of $70.00 per share was also much less than the appraised fair market value of $128.35 per preferred share calculated by Willamette in its latest draft report. As part of the same transaction, Sydnor retained his common shares in the company, exchanged a note for additional common shares, and received several stock options, resulting in his ownership of approximately twenty-five percent of the recapitalized company. Sydnor also obtained a three-year employment contract and other benefits to the detriment of the preferred shareholders.[2] "Fisketjon agreed to sell his common stock to . . .McGraw for a total value of approximately $584,387.02 or $66.23 per common share." (J.A. at 141.)

N. Glenn Smith was an employee with McGraw from October 1968 until December 1997. On February 16, 1998, Smith submitted his distribution request and pursuant to his election, received a cash distribution in March 1998 of $24,893.88, representing the value of his 401(k) account. On April 22, 1998, Smith brought suit against Sydnor and McGraw, alleging, inter alia, that they breached their fiduciary duties to participants in the 401(k) Plan. After Sydnor and McGraw filed Rule 12(b)(6) motions to dismiss, Smith moved for leave to file an amended complaint. At a hearing on Sydnor's and McGraw's motions to dismiss, the district court granted Smith's unobjected-to motion to amend

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[2] Smith alleges that Sydnor received, as part of the three-year employment agreement: (1) an annual salary of $190,000.00, (2) a company car guaranteed to be "no worse" than a 1996 Lexus sedan, (3) country club membership, (4) life insurance, and (5) the titles of President and Chief Operating Officer. Smith alleges that, in addition, CNC granted Sydnor two separate stock option packages and arranged for McGraw to repay a promissory note it owed to Sydnor for $300,000 by selling Sydnor 5,134.89 shares of common stock. According to Smith, Sydnor's package of benefits was worth a total of almost $1 million.

his complaint. Smith filed an amended complaint on behalf of himself and employees and former employees of McGraw who were beneficial owners of shares of preferred stock of McGraw pursuant to the ESOP and on behalf of the 401(k) Plan.

Count One of the amended complaint alleged that Sydnor and McGraw breached their fiduciary duties as trustees for the 401(k) Plan in violation of ERISA §§ 404 and 406, 29 U.S.C.A. §§ 1104 and 1106, respectively,[3] by

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[3] ERISA § 404(a)(1) provides, in relevant part:

> Subject to sections 1103(c) and (d), 1342, and 1344 of this title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and --
>
> (A) for the exclusive purpose of:
>
> (i) providing benefits to participants and their beneficiaries; and
>
> (ii) defraying reasonable expenses of administering the plan;
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> (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

29 U.S.C.A. § 1104(a)(1)(A)-(B) (West 1999). ERISA § 406 provides, in relevant part:

> (a) Transactions between plan and party in interest
>
> Except as otherwise provided in section 1108 of this title:
>
> (1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct

(1) selling the preferred stock at a grossly undervalued price and engaging in self-dealing conduct throughout the transactions to the detriment of the Plan participants and beneficiaries; (2) failing to employ the appropriate methods to investigate the investment, and, thus, failing to act with the care and skill of a prudent person; (3) causing the 401(k) Plan to sell its assets to a party in interest; (4) dealing with the 401(k) Plan's assets in their own interest and/or for their own account; (5) acting in a capacity involving the 401(k) Plan on behalf of a party whose interests were adverse to the 401(k) Plan and its participants; and (6) receiving consideration for their own personal account from CNC (and from CNC and/or McGraw in Sydnor's case) in connection with a transaction involving 401(k) Plan assets. Count Two alleged that McGraw failed to discharge its duties as a co-fiduciary with respect to the 401(k) Plan in violation of

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> or indirect [list of prohibited transactions with party in interest, including sale of assets].
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> . . . .
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> (b) Transactions between plan and fiduciary
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> A fiduciary with respect to a plan shall not --
>
> (1) deal with the assets of the plan in his own interest or for his own account,
>
> (2) in his individual or in any other capacity act in any transaction on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or
>
> (3) receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

29 U.S.C.A. § 1106(a)-(b) (West 1999).

ERISA § 405, 29 U.S.C.A. § 1105,[4] by (1) participating in and/or concealing Sydnor's numerous breaches of fiduciary duty, (2) failing to take reasonable efforts to remedy Sydnor's numerous breaches, and (3) failing to fulfill its own fiduciary duties under 29 U.S.C.A. § 1104(a)(1). Count Three alleged ultra vires conduct by McGraw. Count Four alleged breach of contract by McGraw. Pursuant to ERISA §§ 409 and 502, 29 U.S.C.A.§§ 1109 and 1132, respectively,[5] the amended complaint sought damages in the

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[4] ERISA § 405(a) provides:

> In addition to any liability for which he may have under any other provisions of this part, a fiduciary with respect to a plan shall be liable for a breach of fiduciary responsibility of another fiduciary with respect to the same plan in the following circumstances:
>
> (1) if he participates knowingly in, or knowingly undertakes to conceal, an act or omission of such other fiduciary, knowing such act or omission is a breach;
>
> (2) if, by his failure to comply with section 1104(a)(1) of this title in the administration of his specific responsibilities which give rise to his status as a fiduciary, he has enabled such other fiduciary to commit a breach; or
>
> (3) if he has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach.

29 U.S.C.A. § 1105(a) (West 1999).

[5] ERISA § 409(a) provides, in relevant part:

> Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan

amount of $1,303,623.50 plus unpaid dividends on behalf of the plaintiff class.

On July 21, 1998, the district court issued a Memorandum Opinion finding that Smith's claims for breach of fiduciary duties were merely a recasting of a claim for benefits, which requires exhaustion of internal remedies before a plaintiff can bring an ERISA action in federal court. Based upon this finding, the district court concluded that Smith's claims were premature and not reviewable. The district court also declined to consider Counts Three and Four, on the ground that they related directly to Smith's ERISA claims. Accordingly, the district court dismissed Smith's case without prejudice. In the accompanying Order, the district court also granted Smith's motion for leave to file an amended complaint. Smith filed a timely notice of appeal on August 20, 1998.

II.

Because this case is on appeal from a Rule 12(b)(6) dismissal, our review is de novo. See Mylan Lab., Inc. v. Matkari, 7 F.3d 1130, 1134 (4th Cir. 1993). We will not affirm the district court's dismissal of Smith's amended complaint for failure to state a claim unless it appears certain that Smith can prove no set of facts that would support his claim and would entitle him to relief. See id. We accept as true all of Smith's well-pleaded allegations and view the amended complaint in the light most favorable to him. See id.

> by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary.

29 U.S.C.A. § 1109(a) (West 1999). ERISA § 502(a)(2) provides that a civil action may be brought "by the Secretary, or by a participant, beneficiary or fiduciary for appropriate relief under section 1109 of this title." 29 U.S.C.A. § 1132(a)(2) (West 1999).

III.

Smith argues that the district court's decision that his claims for breach of fiduciary duties by Sydnor and McGraw were merely a recasting of a claim for benefits was erroneous because the allegations of self-dealing and imprudent conduct and underselling Plan assets for personal profit by Sydnor and McGraw clearly stated claims for breach of fiduciary duties. Smith further argues that claims for breach of fiduciary duties, as statutory claims, are not subject to the exhaustion requirement. In the alternative, Smith argues that even if his claims are construed as claims for benefits, exhaustion should be excused because it would be futile in light of the lack of procedures and remedies in the Plan to address claims for breach of fiduciary duties.

A.

The first issue we must address is whether the district court correctly characterized Smith's claims as a recasting of a claim for benefits that requires exhaustion of internal plan provisions before a plaintiff can bring suit in federal court. The parties do not dispute that this case is governed by ERISA. Although ERISA does not explicitly contain an exhaustion requirement, "an ERISA claimant generally is required to exhaust the remedies provided by the employee benefit plan in which he participates as a prerequisite to an ERISA action for denial of benefits under 29 U.S.C. § 1132." Makar v. Health Care Corp., 872 F.2d 80, 82 (4th Cir. 1989). Requiring exhaustion of administrative remedies for such claims gives force to ERISA's explicit requirement that benefit plans covered by ERISA provide internal dispute resolution procedures for participants whose claims for benefits have been denied. See id. at 83. Exhaustion also "enables plan fiduciaries to efficiently manage their funds; correct their errors; interpret plan provisions; and assemble a

factual record which will assist a court in reviewing the fiduciaries' actions." Id.

In its decision, the district court first took notice of the exhaustion requirement. The district court then noted that although Smith framed his suit in terms of breaches of fiduciary duties by Sydnor and McGraw, he sought to recover the difference between the $70 per share he received when he left his employment with McGraw and the $260.31 per share plus interest provided in the Articles of Incorporation for the fifty-eight shares of preferred stock owned by the ESOP and allocated to Smith's account in the ESOP. Relying on Simmons v. Willcox, 911 F.2d 1077 (5th Cir. 1990), and Drinkwater v. Metropolitan Life Ins. Co., 846 F.2d 821 (1st Cir. 1988), the district court construed Smith's claims for breach of fiduciary duties as a recasting of a claim for benefits and an attempt to circumvent the exhaustion requirement. Accordingly, the district court concluded that Smith's filing was premature because he had not yet availed himself of review procedures provided by the plan.[6]

We now turn to the two main cases cited by the district court to determine whether they support the district court's conclusion that Smith's claims are an attempt to evade the exhaustion requirement. In Drinkwater, the plaintiff brought suit in federal court claiming that his employer had breached its fiduciary duty by denying him benefits under the more favorable terms of a new disability plan. See Drinkwater, 846 F.2d at 823-24. The First Circuit rejected Drinkwater's argument that his claim for past due benefits was based upon the violation of his statutory rights under

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[6] As required by ERISA § 503, 29 U.S.C.A. § 1133 (West 1999), the 401(k) Plan contained a detailed procedure for a plan participant to file a claim with the plan administrator and either receive the benefits he requested or a detailed explanation of why his claim was denied. Any participant who was denied benefits was entitled to a formal hearing upon filing a request for a hearing with the plan administrator. The plan administrator was required to produce a final decision on the claim within sixty days of receipt of the appeal, absent special circumstances.

ERISA and thus not subject to the exhaustion requirement. See id. at 826. The court concluded that Drinkwater's claim was "a simple contract claim artfully dressed in statutory clothing" and to allow him to proceed without exhausting review procedures provided by the plan would render meaningless the exhaustion requirement. Id.

In Simmons, the plaintiff argued that the defendants had breached their fiduciary duty by withholding information regarding the status of her benefits, and, therefore, exhaustion should not be required with regard to her claims for benefits and for breach of fiduciary duty. See Simmons, 911 F.2d at 1081. The Fifth Circuit rejected Simmons's allegation that the defendants withheld information regarding the status of her benefits and concluded that she had no cause of action for denial of benefits because she failed to exhaust her administrative remedies. See id. With regard to Simmons's claim for breach of fiduciary duty, which was also based upon the defendants' alleged withholding of information regarding her benefits, the court found the reasoning in Drinkwater to be persuasive and concluded that Simmons must exhaust her administrative remedies before bringing such a claim in federal court. See id.; see also Weiner v. Klais & Co., 108 F.3d 86, 91 (6th Cir. 1997) (citing Drinkwater in holding that plaintiff cannot get around exhaustion requirement by pleading a claim for breach of fiduciary duty where basis of claim is denial of benefits).

We interpret Drinkwater and Simmons to require a plaintiff to exhaust administrative remedies before bringing a claim for breach of fiduciary duty in federal court where the basis of the claim is a plan administrator's denial of benefits or an action by the defendant closely related to the plaintiff's claim for benefits, such as withholding of information regarding the status of benefits. Under those circumstances, it is clear that such a claim is a naked attempt to circumvent the exhaustion requirement. This interpretation is consistent with our prior decision in Coyne & Delany Co. v. Blue Cross

& Blue Shield, 102 F.3d 712 (4th Cir. 1996), where we considered whether a company had a cause of action under ERISA to seek reimbursement from an insurance company for medical expenses incurred by one of its employees. See id. at 713-14. We noted that although Coyne pleaded its claim as a breach of fiduciary duty, it in actuality sought benefits, for which it had no cause of action because the specific terms of ERISA § 502(a)(1)(B) limited a cause of action for benefits to participants and beneficiaries of the ERISA-regulated plan. See id. at 714. We concluded that "[t]o permit the suit to proceed as a breach of fiduciary duty action would encourage parties to avoid the implications of section 502(a)(1)(B) by artful pleading; indeed every wrongful denial of benefits could be characterized as a breach of fiduciary duty under Coyne's theory." Id. In sum, Drinkwater, Simmons, and Coyne & Delany instruct us that a claim for breach of fiduciary duty is actually a claim for benefits where the resolution of the claim rests upon an interpretation and application of an ERISA-regulated plan rather than upon an interpretation and application of ERISA.

We find no such "artful pleading" in this case. In Smith's amended complaint, he alleges that Sydnor and McGraw failed to discharge their fiduciary duties with regard to the 401(k) Plan as required by ERISA §§ 404 and 406 by selling the preferred stock at a grossly undervalued price and engaging in self-dealing conduct to the detriment of Plan participants and beneficiaries, by failing to act in a prudent manner in investigating the transaction with CNC, and by acting on behalf of an adverse party in a transaction with CNC. Smith also alleges that McGraw violated its co-fiduciary duties under ERISA § 405 by participating in, concealing, and failing to remedy Sydnor's numerous breaches of fiduciary duties. Unlike the plaintiffs in the above cases, Smith does not challenge a denial of benefits or an action related to a denial of benefits, but rather the conduct of Sydnor and McGraw that he claims has lowered the value of his and the other participants' 401(k) Plan

accounts. Indeed, Smith has alleged a set of facts that, if proven, would constitute breaches of fiduciary duties by Sydnor and McGraw under ERISA independent of a claim for benefits. See, e.g., Felber v. Estate of Regan, 117 F.3d 1084, 1086-88 (8th Cir. 1997) (finding breach of fiduciary duties under ERISA §§ 404 and 406 where trustee of ERISA plan engaged in self-dealing and imprudent transactions); Concha v. London, 62 F.3d 1493, 1500-04 (9th Cir. 1995) (reversing district court dismissal of claims for breach of fiduciary duties under ERISA §§ 404 and 406 where plaintiffs alleged that fiduciaries of ERISA plan engaged in prohibited transactions, failed to discharge their duties in a prudent manner, and failed to diversify the assets of the plan); Reich v. Compton, 57 F.3d 270, 287-91 (3d Cir. 1995) (reversing district court grant of summary judgment in favor of defendant trustees on claims for breach of fiduciary duties under ERISA §§ 404 and 406 where evidence suggested that trustees may have acted on behalf of an adverse party in a transaction with the plan and may have violated the duties of loyalty and prudence).

We find further support in Smith's amended complaint for our conclusion that he has pleaded valid claims for breach of fiduciary duties by Sydnor and McGraw. Under ERISA, damages for breach of fiduciary duty inure to the benefit of the plan as a whole rather than to individuals. See Massachusetts Mut. Life Ins. Co. v. Russell, 473 U.S. 134, 140-44 (1985). Smith's amended complaint states that Smith "brings this action on behalf of himself and all other members of the class defined herein and on behalf of the James McGraw, Inc. 401(k) Plan." (J.A. at 134 (emphasis added).) As a remedy, Smith seeks, inter alia, that the district court order Sydnor and McGraw to disgorge all profits from the transaction with CNC and that it order the rescission of the sale of the preferred stock to McGraw and reinstate the 401(k) Plan's option to "put" the stock. This remedy is precisely what ERISA § 409 provides. Although this remedy will undoubtedly benefit Smith and other participants in the

Plan, it does not solely benefit the individual participants. See Horan v. Kaiser Steel Retirement Plan, 947 F.2d 1412, 1417-18 (9th Cir. 1991) (finding a failure to state a claim by plaintiffs who claimed breach of fiduciary duty and sought annuities for individual plaintiffs, which would only benefit the plaintiffs and not the plan). In accordance with Russell, any recovery against Sydnor and McGraw must be paid to the Plan and not to individual participants.

In sum, because the resolution of Smith's claims rests upon the interpretation and application of ERISA rather than simply upon the interpretation and application of the 401(k) Plan, we conclude that Smith has pleaded valid claims for breach of fiduciary duties.

B.

Having concluded that Smith's claims for breach of fiduciary duties are not a mere recasting of a claim for benefits, we now reach the issue not addressed by the district court -- whether exhaustion of internal plan remedies is required before Smith can file suit claiming breach of fiduciary duties in federal court. While the courts of appeals are in near unanimity that exhaustion of administrative remedies is required before a plaintiff can bring an ERISA action in federal court to recover benefits under a plan, see Fallick v. Nationwide Mut. Ins. Co., 162 F.3d 410, 418 & n.4 (6th Cir. 1998) (listing cases), they are in sharp disagreement as to whether a plaintiff must exhaust administrative remedies before bringing an action in federal court to assert a violation of an ERISA statutory provision, such as a claim for breach of fiduciary duty. Compare Lindemann v. Mobil Oil Corp., 79 F.3d 647, 649-50 (7th Cir. 1996) (holding that district court has discretion to require exhaustion for ERISA § 510 claim); Mason v. Continental Group, Inc., 763 F.2d 1219, 1226-27 (11th Cir. 1985) (holding that exhaustion is required for ERISA § 510 claim and claims for breach of fiduciary duties), with Chailland v. Brown & Root, Inc., 45

F.3d 947, 950-51 (5th Cir. 1995) (holding that exhaustion is not required for ERISA § 510 claim where plan is incapable of providing a remedy); Richards v. General Motors Corp., 991 F.2d 1227, 1235 (6th Cir. 1993) (holding that exhaustion is not required for ERISA § 510 claim); Horan, 947 F.2d at 1416 n.1 ("The exhaustion requirement applies to plaintiffs' benefits claim, but does not apply to the plaintiffs' fiduciary breach claim because this claim alleges a violation of the statute, ERISA, rather than the Plan."); Held v. Manufacturers Hanover Leasing Corp., 912 F.2d 1197, 1204-05 (10th Cir. 1990) (holding that exhaustion is not required for ERISA§ 510 claim); Molnar v. Wibbelt, 789 F.2d 244, 250 n.3 (3d Cir. 1986) (stating in dicta that exhaustion is not required for claim for breach of fiduciary duty).[7]

The issue appears to be one of first impression in this Circuit.[8] For a number of reasons, we are persuaded that a plaintiff is not required to exhaust administrative remedies before bringing an action in federal court alleging a breach of fiduciary duty in violation of ERISA §§ 404-406. First, the exhaustion requirement is premised on ERISA's statutory mandate that benefit plans covered by the Act provide an

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[7] Although the majority of these cases involve an alleged unlawful termination in violation of ERISA § 510, 29 U.S.C.A. § 1140, the reasoning of these cases applies equally to claims for breach of fiduciary duty, which are statutory claims as well. In fact, the district court noted that "Defendants do not challenge plaintiff's proposition that the exhaustion requirement applies only to benefit claims because fiduciary duty claims allege violations of the statute, ERISA, rather than a violation of an employee benefit plan." (J.A. at 131-32.)

[8] The published opinions in this Circuit discuss the exhaustion requirement in the context of a denial of benefits. See Coyne & Delany Co. v. Blue Cross & Blue Shield, 102 F.3d 712, 716-17 (4th Cir. 1996) (holding that fiduciaries cannot sue for benefits based in part upon fact that fiduciaries cannot file a claim for benefits, and, thus, cannot exhaust plan claim procedures); Hickey v. Digital Equip. Corp., 43 F.3d 941, 945 (4th Cir. 1995) (holding that employees were required to exhaust administrative remedies before bringing suit for severance benefits).

internal review procedure for plan participants to appeal a denial of benefits. See Makar, 872 F.2d at 83 ("It would be 'anomalous' if the same reasons which led Congress to require plans to provide remedies for ERISA claimants did not lead courts to see that those remedies are regularly utilized."). There is no statutory mandate for benefit plans to provide review of claims for violation of ERISA itself. See Zipf v. AT&T Co., 799 F.2d 889, 891-92 (3d Cir. 1986); Amaro v. Continental Can Co., 724 F.2d 747, 751-52 (9th Cir. 1984). This distinction is significant, as this Court has noted in dictum:

> It is undisputed that the administrative appeals procedure ERISA requires in every plan does not apply to non-benefit challenges. Yet it is this statutory requirement upon which the judicially-created exhaustion requirement is grounded. It follows, therefore, that if there is no statutory requirement for an appeals procedure respecting claims not involving benefits, the logic of the exhaustion requirement no longer applies.

Licensed Div. Dist. No. 1 v. Defries, 943 F.2d 474, 479 (4th Cir. 1991) (citations omitted).

The very nature of a claim for a violation of an ERISA statutory provision further supports the conclusion that it is not subject to the exhaustion requirement. Unlike a claim for benefits under a plan, which implicates the expertise of a plan fiduciary, adjudication of a claim for a violation of an ERISA statutory provision involves the interpretation and application of a federal statute, which is within the expertise of the judiciary. Cf. Makar, 872 F.2d at 83 (noting the value of administrative review). As such, "one of the primary justifications for an exhaustion requirement in other contexts, deference to administrative expertise, is simply absent." Zipf , 799 F.2d at 893. "Indeed, there is a

strong interest in judicial resolution of these [ERISA statutory] claims, for the purpose of providing a consistent source of law to help plan fiduciaries and participants predict the legality of proposed actions." Id. (regarding an ERISA§ 510 claim). Because no deference is due plan fiduciaries, the policy considerations cited in favor of the exhaustion requirement by this Court in Makar -- enabling plan fiduciaries to manage their funds, correct their errors, interpret plan provisions, and assemble a factual record for a reviewing court -- are simply not present in a claim for violation of an ERISA statutory provision.

In light of these considerations, we hold that the judicially created exhaustion requirement does not apply to a claim for breach of fiduciary duty as defined in ERISA.[9]

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[9] We find further support for our holding by analogy to the standards for our review of actions of an ERISA plan fiduciary who has been given discretionary authority to determine eligibility for benefits and to interpret the language of an ERISA plan. In general, deference must be shown to such discretionary actions, which will be reviewed only for abuse of that discretion. See Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 111 (1989). If the fiduciary is acting under a conflict of interest, however, "that conflict must be weighed as a 'facto[r] in determining whether there is an abuse of discretion.'" Id. at 115 (quoting Restatement (Second) of Trusts § 187 cmt. d (1959)). This Court has formulated the weighing of the conflict-of-interest factor in the following manner:

> [W]hen a fiduciary exercises discretion in interpreting a disputed term of the contract where one interpretation will further the financial interests of the fiduciary, we will not act as deferentially as would otherwise be appropriate. Rather, we will review the merits of the interpretation to determine whether it is consistent with an exercise of discretion by a fiduciary acting free of the interests that conflict with those of the beneficiaries. In short, the fiduciary decision will be entitled to some deference, but this deference will be lessened to the degree necessary to neutralize any untoward influence resulting from the conflict.

That the language of the 401(k) Plan makes no provision for handling this type of claim is further support for not referring this type of claim to the Plan for administrative consideration. See Defries, 943 F.2d at 479 (noting that lack of procedures in plan for appeal of non-benefit issues is further evidence that appeals procedure required by ERISA does not apply to non-benefit challenges). Because Smith has pleaded valid claims for breach of fiduciary duties defined in §§ 404-406 of ERISA by Sydnor and McGraw, he is not required to exhaust internal plan provisions before bringing suit in federal court.[10]

IV.

In sum, we conclude that Smith's amended complaint alleges facts that, if proven, show that Sydnor and McGraw breached their fiduciary duties to the participants in the 401(k) Plan and that Smith is not required to exhaust internal plan provisions before bringing suit in federal court asserting violations of §§ 404-406 of ERISA. We therefore reverse the district court's dismissal of Smith's action and remand with the instruction to reinstate his amended complaint.

REVERSED AND REMANDED

Doe v. Group Hospitalization & Medical Servs., 3 F.3d 80, 87 (4th Cir. 1993). By allowing a plaintiff to bring a claim for breach of fiduciary duty in federal court before exhausting administrative remedies, we recognize the general principle enunciated in Doe that we do not give full credence to an ERISA fiduciary's assessment of his own allegedly wrongful conduct.

[10] Our conclusion means we need not decide whether exhaustion would be futile and thus could be excused. See, e.g., Licensed Div. Dist. No. 1 v. Defries, 943 F.2d 474, 479 (4th Cir. 1991) (holding that exhaustion of administrative remedies would be futile where the plaintiff union sought a ruling that it had the authority to remove the incumbent trustees of the union benefit plan and appoint new ones).

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA

Richmond Division

N. GLENN SMITH,

Plaintiff,

v.

GEORGE W. SYDNOR, JR and
THE McGRAW GROUP, INC.,

Defendants.

Civil Action Number 3:98CV241

Entered: July 21, 1998

MEMORANDUM OPINION

This matter is before the Court on the defendants' joint motion to dismiss. The plaintiff, N. Glenn Smith, brings this suit for himself and all Plan Participants similarly situated on behalf of the James McGraw Inc. ("McGraw") 401 (k) plan. The action arises under Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1001 et seq. Smith's Amended Complaint raises four claims.[1] In Count One the plaintiff alleges a breach of fiduciary duty by Sydnor and McGraw. In Count Two, the plaintiff alleges a breach of fiduciary duty by co-fiduciary, McGraw. Count Three alleges ultra vires and Count Four is a breach of contract claim against McGraw.

On January 1, 1989, McGraw established an Employee Stock Ownership Plan ("ESOP") for the benefit of its employees. McGraw employees were advised of their

[1] By Order accompanying this Memorandum Opinion, the Court GRANTS plaintiff's motion for leave to file first amended complaint.

rights and benefits under the plan and ERISA in a Summary Plan Description. Plan participants were advised that the plan and trust documents would control the administration of the ESOP. On December 29, 1989, McGraw filed amended and restated Articles of Incorporation. The Articles provided that preferred stock could be issued only to the ESOP or to participants in the ESOP. The Articles also stated that at any time following the earlier of December 19, 1996, or the date at which a loan agreement between McGraw and ESOP was satisfied (the "redemption date"), plan participants who held preferred stock pursuant to a distribution from the ESOP could require their stock be redeemed at a price of $260.31 per share. Effective January 1, 1999, McGraw converted the ESOP into the 401(k) plan.

In 1996, McGraw began experiencing financial difficulties, which led to discussions in 1996 with Columbia Naples Capital, L.L.C. ("CNC") concerning a potential investment of capital in McGraw. A precondition of the transaction was the purchase by McGraw of the preferred stock held by the 401(k) plan. McGraw purchased the stock for $70.00 per share. The plaintiff was an employee with McGraw from October 1968 until December 1997. On February 16, 1998, Smith submitted his distribution request and pursuant to his election, he received a cash distribution in March 1998 of $24,893.88, representing the value of his 401(k) account.

The first issue of importance is whether plaintiff's claims are claims for breach of fiduciary duty or merely a recasting of a denial of benefits claim. The legal framework is not in dispute. Plaintiff concedes that exhaustion of internal remedies is required before an employee can pursue an ERISA action for denial of benefits. Makar v. Health Care Corp. Of Mid-Atlantic, 872 F.2d 80, 82 (4th Cir. 1989). This promotes the consistent treatment of benefit claims and avoids clogging the federal courts with benefit disputes. Id. at 83; Amato v. Bernard, 618 F.2d 559, 567 (9th Cir. 1980). Defendants do not challenge plaintiff's proposition that the

exhaustion requirement applies only to benefit claims because fiduciary duty claims allege violations of the statute, ERISA, rather than a violation of an employee benefit plan. See Horan v. Kaiser Steel Retirement Plan, 947 F.2d 1412, 1416 n.1 (9th Cir. 1991); Amato v. Continental Can Co., 724 F.2d 747 (9th Cir. 1984). They argue instead that the plaintiff has wrongly classified his claims in an effort to circumvent the exhaustion requirement, which is impermissible under Fourth Circuit law. See Coyne & Delaney Co. V. Blue Cross & Blue Shield of Virignia, 102 F.3d 712, 714 (4th Cir. 1996).

Defendants' argument is persuasive. In this case Smith seeks to recover the difference between $70 per share and $260.31 per share, for the 58 shares of preferred stock owned by the ESOP and allocated to Smith's account in the ESOP. Although he alleges the defendants breached their fiduciary duty, he is in fact claiming that he is owed the $260.31 per share plus interest that is discussed in the Articles of Incorporation. The fact that a plaintiff may state a claim for breach of fiduciary duty does not remove the exhaustion requirement when the claim is, in essence, a denial of benefit claim. See, Simmons v. Wilcox, 911 F.2d 1077 (5th Cir. 1990); Drinkwater v. Metro Life Ins. Co. 846 F.2d 821, 825-26 (1st Cir. 1988). This is precisely what Smith attempts to do in this case.

Accordingly, the Court finds that Smith's filing is premature and will not be reviewed by the Court. The plan provides the review procedures as required by ERISA and plaintiff is directed to avail himself of them should he be so advised. Count Three and Count Four directly relate to plaintiff's ERISA claims and the Court declines to consider them. The case is DISMISSED WITHOUT PREJUDICE.

July 21, 1998
DATE

Richard L. Williams
SENIOR UNITED STATES
DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA

Richmond Division

N. GLENN SMITH,

Plaintiff,

v.

GEORGE W. SYDNOR, JR and
THE McGRAW GROUP, INC.,

Defendants.

Civil Action Number 3:98CV241

Entered: July 21, 1998

ORDER

This matter is before the Court on the Plaintiff's motion for leave to file an amended complaint and defendant's motion to dismiss. Plaintiff's motion to file amended complaint is GRANTED. For the reasons stated in the Memorandum Opinion, the defendant's motion to dismiss is GRANTED and the case is DISMISSED WITHOUT PREJUDICE.

It is so ORDERED.

Let the Clerk send a copy of this Order and the accompanying Memorandum Opinion to all counsel of record.

July 21, 1998
DATE

Richard L. Williams
SENIOR UNITED STATES
DISTRICT JUDGE

TITLE 29. LABOR
CHAPTER 18. EMPLOYEE RETIREMENT INCOME SECURITY PROGRAM PROTECTION OF EMPLOYEE BENEFIT RIGHTS GENERAL PROVISIONS

29 USCS § 1001 (1999)

§ 1001. Congressional findings and declaration of policy

(a) Benefit plans as affecting interstate commerce and the Federal taxing power. The Congress finds that the growth in size, scope, and numbers of employee benefit plans in recent years has been rapid and substantial; that the operational scope and economic impact of such plans is increasingly interstate; that the continued well-being and security of millions of employees and their dependents are directly affected by these plans; that they are affected with a national public interest; that they have become an important factor affecting the stability of employment and the successful development of industrial relations; that they have become an important factor in commerce because of the interstate character of their activities, and of the activities of their participants, and the employers, employee organizations, and other entities by which they are established or maintained; that a large volume of the activities of such plans are carried on by means of the mails and instrumentalities of interstate commerce; that owing to the lack of employee information and adequate safeguards concerning their operation, it is desirable in the interests of employees and their beneficiaries, and to provide for the general welfare and the free flow of commerce, that disclosure be made and safeguards be provided with respect to the establishment, operation, and administration of such plans; that they substantially affect the revenues of the United States because they are afforded preferential Federal tax treatment; that despite the enormous growth in such plans many employees with long years of employment are losing

anticipated retirement benefits owing to the lack of vesting provisions in such plans; that owing to the inadequacy of current minimum standards, the soundness and stability of plans with respect to adequate funds to pay promised benefits may be endangered; that owing to the termination of plans before requisite funds have been accumulated, employees and their beneficiaries have been deprived of anticipated benefits; and that it is therefore desirable in the interests of employees and their beneficiaries, for the protection of the revenue of the United States, and to provide for the free flow of commerce, that minimum standards be provided assuring the equitable character of such plans and their financial soundness.

(b) Protection of interstate commerce and beneficiaries by requiring disclosure and reporting, setting standards of conduct, etc., for fiduciaries. It is hereby declared to be the policy of this chapter to protect interstate commerce and the interests of participants in employee benefit plans and their beneficiaries, by requiring the disclosure and reporting to participants and beneficiaries of financial and other information with respect thereto, by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions, and ready access to the Federal courts.

(c) Protection of interstate commerce, the Federal taxing power, and beneficiaries by vesting of accrued benefits, setting minimum standards of funding, requiring termination insurance. It is hereby further declared to be the policy of this chapter to protect interstate commerce, the Federal taxing power, and the interests of participants in private pension plans and their beneficiaries by improving the equitable character and the soundness of such plans by requiring them to vest the accrued benefits of employees with significant periods of service, to meet minimum standards of funding, and by requiring plan termination insurance.

TITLE 29. LABOR
CHAPTER 18. EMPLOYEE RETIREMENT INCOME SECURITY PROGRAM PROTECTIONS OF EMPLOYEE BENEFIT RIGHTS REGULATORY PROVISIONS FIDUCIARY RESPONSIBILITY

29 USCS § 1109 (1999)

§ 1109. Liability for breach of fiduciary duty

(a) Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary. A fiduciary may also be removed for a violation of section 1111 of this title.

(b) No fiduciary shall be liable with respect to a breach of fiduciary duty under this subchapter if such breach was committed before he became a fiduciary or after he ceased to be a fiduciary.

TITLE 29. LABOR
CHAPTER 18. EMPLOYEE RETIREMENT INCOME SECURITY PROGRAM PROTECTION OF EMPLOYEE BENEFIT RIGHTS REGULATORY PROVISIONS ADMINISTRATION AND ENFORCEMENT

29 USCS § 1133 (1999)

§ 1133. Claims procedure

In accordance with regulations of the Secretary, every employee benefit plan shall - -

(1) provide adequate notice in writing to any participant or beneficiary whose claim for benefits under the plan has been denied, setting forth the specific reasons for such denial, written in a manner calculated to be understood by the participant, and
(2) afford a reasonable opportunity to any participant whose claim for benefits has been denied for a full and fair review by the appropriate named fiduciary of the decision denying the claim.

TITLE 29 - - LABOR
SUBTITLE B - - REGULATIONS RELATING TO LABOR
CHAPTER XXV--PENSION AND WELFARE BENEFITS ADMINISTRATION, DEPARTMENT OF LABOR
SUBCHAPTER G - - ADMINISTRATION AND ENFORCEMENT UNDER THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974
PART 2560--RULES AND REGULATIONS FOR ADMINISTRATION AND ENFORCEMENT

29 CFR 2560.503-1

§ 2560.503-1 Claims procedure.

(a) Scope and purpose. (1) This section sets out certain minimum requirements for employee benefit plan procedures pertaining to claims by participants and beneficiaries (claimants) for plan benefits, consideration of such claims, and review of claim denials, hereinafter referred to in the aggregate as ``claims procedures.'' Except as otherwise noted, these requirements apply to every employee benefit plan described in section 4(a) and not exempted under section 4(b) of the Employee Retirement Income Security Act of 1974 (the Act).

(b) Obligation to establish a reasonable claims procedure. Every employee benefit plan shall establish and maintain reasonable claims procedures.

(1) A claims procedure will be deemed to be reasonable only if it:

(i) Complies with the provisions of paragraphs (d) through (h) of this section, except to the extent that it is deemed to comply with some
or all of such provisions under the authority of paragraph (b)(2) or paragraph (j) of this section.

(ii) Is described in the summary plan description, as required by Sec. 2520.102-3,

(iii) Does not contain any provision, and is not administered in a way, which unduly inhibits or hampers the initiation or processing of plan claims, and

(iv) Provides for informing participants in writing, in a timely fashion, of the time limits set forth in paragraphs (e)(3) and (g)(3) and paragraph (h) of this section.

(2) In the case of a plan established and maintained pursuant to a collective bargaining agreement (other than a plan subject to the provisions of section 302(c)(5) of the Labor Management Relations Act, 1947 concerning joint representation on the board of trustees):

(i) Such plan will be deemed to comply with the provisions of paragraphs (d) through (h) of this section if the collective bargaining agreement pursuant to which the plan is established or maintained sets forth or incorporates by specific reference.

(A) Provisions concerning the filing of benefit claims and the initial disposition of benefit claims, and

(B) A grievance and arbitration procedure to which denied claims are subject.

(ii) Such plan will be deemed to comply with the provisions of paragraphs (g) and (h) of this section (but will not be deemed to comply with paragraphs (d) through (f)) if the collective bargaining agreement pursuant to which the plan is established or maintained sets forth or incorporates by specific reference a grievance and arbitration procedure to which denied claims are subject (but not provisions concerning the final and initial disposition of benefit claims).

(c) Claims procedure for an insured welfare or pension plan. (1) To the extent that benefits under an employee benefit plan are provided or administered by an insurance company, insurance service, or other similar organization which is subject to regulation under the insurance laws of one or more States, the claims procedure pertaining to such benefits may provide for filing of a claim for benefits with and notice of decision by such company, service or organization.

(2) See paragraph (g) regarding review and final decision on denied claims by insurance companies, insurance services and similar organizations.

(d) Filing of a claim for benefits. For purposes of this section, a claim is a request for a plan benefit by a participant or beneficiary. A claim is filed when the requirements of a reasonable claim filing procedure of a plan have been met. If a reasonable procedure for filing claims has not been established by the plan, a claim shall be deemed filed when a written or oral communication is made by the claimant or the claimant's authorized representative which is reasonably calculated to bring the claim to the attention of:

(1) In the case of a single employer plan, either the organizational unit which has customarily handled employee benefits matters of the employer, or any officer of the employer.

(2) In the case of a plan to which more than one unaffiliated employer contributes, or which is established or maintained by an employee organization, either the joint board, association, committee or other similar group (or any member of any such group) administering the plan, or the person or organizational unit to which claims for benefits under the plan customarily have been referred.

(3) In the case of a plan the benefits of which are provided or administered by an insurance company, insurance service, or other similar organization, which is subject to regulation under the insurance laws of one or more States, the person or organizational unit which handles claims for benefits under the plan or any officer of the insurance company, insurance service, or similar organization.

(4) For purposes of paragraphs (d)(1), (2), and (3) of this section, a communication shall be deemed to have been brought to the attention of an organizational unit if it is received by any person employed in such unit.

(e) Notification to claimant of decision. (1) If a claim is wholly or partially denied, notice of the decision, meeting the requirements of paragraph (f) of this section, shall be furnished to the claimant within a reasonable period of time after receipt of the claim by the plan.

(2) If notice of the denial of a claim is not furnished in accordance with paragraph (e)(1) of this section within a reasonable period of time, the claim shall be deemed denied and the claimant shall be permitted to proceed to the review stage described in paragraph (g) of this section.

(3) For purposes of paragraphs (e)(1) and (2). of this section, a period of time will be deemed to be unreasonable if it exceeds 90 days after receipt of the claim by the plan, unless special circumstances require an extension of time for processing the claim. If such an extension of time for processing is required, written notice of the extension shall be furnished to the claimant prior to the termination of the inital 90-day period. In no event shall such extension exceed a period of 90 days from the end of such initial period. The extension notice shall indicate the special circumstances requiring an extension of time and the date by which the plan expects to render the final decision.

(f) Content of notice. A plan administrator or, if paragraph (c) of this section is applicable, the insurance company, insurance service, or other similar organization, shall provide to every claimant who is denied a claim for benefits written notice setting forth in a manner calculated to be understood by the claimant:

(1) The specific reason or reasons for the denial;

(2) Specific reference to pertinent plan provisions on which the denial is based;

(3) A description of any additional material or information necessary for the claimant to perfect the claim and an explanation of why such material or information is necessary; and (4) Appropriate information as to the steps to be taken if the participant or beneficiary wishes to submit his or her claim for review.

(g) Review procedure. (1) Every plan shall establish and maintain a procedure by which a claimant or his duly authorized representative has a reasonable opportunity to appeal a denied claim to an appropriate named fiduciary or to a person designated by such fiduciary, and under which a full and fair review of the claim and its denial may be obtained. Every such procedure shall include but not be limited to provisions that a claimant or his duly authorized representative may:

(i) Request a review upon written application to the plan;

(ii) Review pertinent documents; and

(iii) Submit issues and comments in writing.

(2) To the extent that benefits under an employee benefit plan are provided or administered by an insurance company, insurance service, or other similar organization which is subject to regulation under the insurance laws of one or more States, the claims procedure pertaining to such benefits may provide for review of and decision upon denied claims by such company, service or organization. In such case, that company, service, or organization shall be the ``appropriate named fiduciary'' for purposes of this section. In all other cases, the ``appropriate named fiduciary'' for purposes of this section may be the plan administrator or any other person designated by the plan, provided that such plan administrator or other person is either named in the plan instrument or is identified pursuant to a procedure set forth in the plan as the person who reviews and makes decisions on claim denials.

(3) A plan may establish a limited period within which a claimant must file any request for review of a denied claim. Such time limits must be reasonable and related to the nature of the benefit which is the subject of the claim and to other attendant circumstances. In no event may such a period expire less than 60 days after receipt by the claimant of written notification of denial of a claim.

(h) Decision on review. (1)(i) A decision by an appropriate named fiduciary shall be made promptly, and shall not ordinarily be made later than 60 days after the plan's receipt of a request for review, unless special circumstances (such as the need to hold a hearing, if the plan procedure provides for a hearing) require an extension of time for processing, in which case a decision shall be rendered as soon as possible, but not later than 120 days after receipt of a request for review.

(ii) In the case of a plan with a committee or board of trustees designated as the appropriate named fiduciary, which holds regularly scheduled meetings at least quarterly, a decision on review shall be made by no later than the date of the meeting of the committee or board which immediately follows the plan's receipt of a request for review, unless the request for review is filed within 30 days preceding the date of such meeting. In such case, a decision may be made by no later than the date of the second meeting following the plan's receipt of the request for review. If special circumstances (such as the need to hold a hearing, if the plan procedure provides for a hearing) require a further extension of time for processing, a decision shall be rendered not later than the third meeting of the committee or board following the plan's receipt of the request for review.

(2) If such an extension of time for review is required because of special circumstances, written notice of the extension shall be furnished to the claimant prior to the commencement of the extension.

(3) The decision on review shall be in writing and shall include specific reasons for the decision, written in a manner calculated to be understood by the claimant, as well as specific references to the pertinent plan provisions on which the decision is based.

(4) The decision on review shall be furnished to the claimant within the appropriate time described in paragraph (h)(1) of this section. If the decision on review is

not furnished within such time, the claim shall be deemed denied on review.

(i) Apprenticeship plans. This section does not apply to employee benefit plans which provide solely apprenticeship training benefits.

(j) Qualified health maintenance organizations. Claims procedures with respect to any benefits provided through membership in a qualified health maintenance organization, as defined in section 1310(d) of the Public Health Service Act, as amended, 42 U.S.C. 300e-9(d), shall be deemed to satisfy the requirements of this section with respect to the provision of such benefits to persons who are members of such qualified health maintenance organization, provided those procedures meet the requirements of section 1301 of the Public Health Service Act, as amended 42 U.S.C. 300e and the regulations thereunder.

99-619

No. _____

Supreme Court, U.S.
FILED
OCT 10 1999
OFFICE OF THE CLERK

In The

Supreme Court of the United States

GEORGE W. SYDNOR, JR. and THE MCGRAW GROUP, INCORPORATED,

Petitioners,

v.

N. GLENN SMITH, For himself and all Plan Participants similarly situated on behalf of the James McGraw, Inc., 401(k) Plan,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether a claim for breach of fiduciary duties by a trustee under the Employee Retirement Income Security Act of 1974 ("ERISA") requires prior exhaustion of internal plan remedies?

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STATUTORY PROVISIONS INVOLVED

The statutory provisions involved are 28 U.S.C. § 1254(1), 29 U.S.C. § 1001, 29 U.S.C. § 1104, 29 U.S.C. § 1105, 29 U.S.C. § 1106, 29 U.S.C. § 1109, 29 U.S.C. § 1132, 29 U.S.C. § 1133 and 29 C.F.R. § 2560.503-1, included in the Appendix at 24-34.

STATEMENT OF THE CASE

Plaintiff, N. Glenn Smith ("Smith") filed this action is a derivative suit filed on behalf of the James McGraw, Inc. 401(k) Plan. It asserts that George W. Sydnor, Jr. ("Sydnor") and The McGraw Group, Inc. ("McGraw") breached their fiduciary duties under 29 U.S.C. § 1104, § 1105 and § 1106.[1] This suit is brought pursuant to 29 U.S.C. § 1132 (a)(2), and seeks to hold Sydnor and McGraw[2] personally liable to the Plan under 29 U.S.C. § 1109.

On January 1, 1989, McGraw established the James McGraw, Inc. Employee Stock Ownership Plan ("ESOP"). App. 3. On December 29, 1989, McGraw adopted the Amended and Restated Articles of Incorporation (the "Articles"). App. 3. The Articles converted the stock held by the ESOP into preferred stock and provided that only preferred stock could be issued to the ESOP. App. 3. The Articles also created a significant "bundle of rights" for this preferred stock, including:

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[1] For purposes of convenience, these sections of ERISA will be referred to as § 404 - § 406.

[2] Both Sydnor and McGraw will also be referred to as the "fiduciaries."

- the right to "put" the preferred stock to the company at a price of $260.31 per share (App. 3);
- the right to receive $260.31 per share, plus unpaid dividends, if McGraw elected to redeem the stock (App. 3); and
- the right to an annual eight percent (8%) cumulative dividend for each share of preferred stock (App. 3).

On January 1, 1993, McGraw converted the ESOP into the James McGraw, Inc. 401(k) (the "Plan"). App. 3. At all relevant times, Sydnor was a trustee and fiduciary with respect to the Plan. App. 3. Sydnor was also the President and Chief Operating Officer ("COO") of McGraw. App. 2. Kenneth Fisketjon ("Fisketjon"), the Chairman and Chief Executive Officer of McGraw, served as co-trustee of the Plan until his resignation three days before the transaction in dispute. App. 3. Sydnor and Fisketjon each held fifty percent of McGraw's common stock. App. 3.

From 1990-1995, McGraw hired Willamette Management Associates ("Willamette") to conduct annual appraisals of the preferred stock. App. 4. Each year, Willamette concluded that the preferred stock had value, but the common stock "ha[d] no residual equity value." App. 4. Based on the rights granted to the preferred stock by the Articles, Willamette determined that the equity value of the company had to be allocated first to the preferred stock up to $260.31 per share. Consequently, the common stock did not have any value until the preferred stock was worth at least $260.31 per share. App. 5. Willamette concluded that the common stock was worthless each year they conducted an appraisal. App. 4.

McGraw's financial condition deteriorated during each year of Sydnor's tenure as the top executive. App. 4. Sydnor searched for investors as McGraw's financial condition worsened. App. 4. In May 1996, McGraw entered into a letter of intent with Columbia Naples Capital, L.L.C. ("CNC") in May 1996. App. 4. McGraw agreed to sell approximately forty-five percent of its common stock to CNC in exchange for a $3 million equity investment. App. 4. Like other investors, CNC was concerned with McGraw's financial obligations to the preferred stock held by the Plan. App. 4. Consequently, sometime late in the negotiations, CNC and Sydnor decided that McGraw needed to redeem the preferred stock because of the substantial liability it posed to the company. App. 4. They agreed that as part of the transaction, McGraw would redeem the preferred stock for $70.00 per share, while Sydnor, Fisketjon and McGraw would receive $66.23 per share for the common stock. App. 4-5.

Sydnor asked Willamette to issue an opinion that $70.00 per share was fair market value for the preferred stock. App. 4. Willamette refused because such an opinion would be inconsistent with its prior appraisals, which allocated all of the equity value of McGraw to the preferred stock and none to the common stock. App. 4. For example, Willamette's latest appraisal was sent to McGraw in August 1996[3] and concluded that "the fair market value as of December 31, 1995 of the [preferred stock] is $900,000 in the aggregate and $128.35 on a per share basis. Based on this value, the Class B common shares have no residual equity value." App. 4. Not surprisingly, Willamette could not agree that $70.00 per share was a fair price for the preferred stock. App. 4.

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[3] The report was dated October 15, 1996, but it was sent to McGraw sometime in August 1996. App. 4.

Undeterred by Willamette's refusal, Sydnor hired Scott & Stringfellow, Inc. to give a "fairness opinion." App. 4. Scott & Stringfellow opined that $70.00 per share was "adequate consideration" for the preferred stock. App. 4. On the same day, McGraw, CNC and Sydnor closed their deals.

As the Plan's sole trustee[4], Sydnor sold the Plan's preferred stock to McGraw for $70.00 per share. App. 4. This price was far less than the $260.31 per share provided by the Articles plus the unpaid dividends of $104.15 per share, totaling $364.46 of value per share of preferred stock. App. 5. The $70.00 per share price was also much less than the appraised value of $128.35 calculated by Willamette in its latest draft report. App. 5.

As part of the same transaction, Sydnor acting as McGraw's President and COO, McGraw sold over 36,000 shares of Class B common stock to CNC at $66.23 per share. In his personal capacity, Sydnor exchanged his shares of common stock for approximately twenty-five percent of the same stock in the recapitalized company. App. 5. His "new" shares were each valued at $66.23 per share. Sydnor also negotiated a three year employment agreement with CNC which provided an annual salary of $190,000.00; a company car guaranteed to be "no worse" than a 1996 Lexus luxury sedan; country club membership; life insurance; and the titles of President and COO. App. 5. Sydnor also received two separate incentive stock option packages and repayment of a $300,000 promissory note owed by McGraw to Sydnor by exchanging the note for shares of common stock valued at $66.23 per share. App. 5. In addition, Fisketjon sold his common stock for $584,387.02 or $66.23 per share. App. 5.

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[4] On September 27, 1996, Fisketjon resigned his position as the Plan's co-trustee -- just three (3) days before the Plan sold the preferred stock to McGraw. App. 4.

ARGUMENT

The fiduciaries – Sydnor and MGraw – profited at the Plan's expense. Smith filed this action as a derivative suit under ERISA § 502(a)(2) for relief under ERISA § 409 for disgorgement of the improper profits and restitution to the Plan.

At the district court, the Defendants argued that Smith's suit was really a disguised benefits claim and should be dismissed because Smith had not exhausted the Plan's internal procedures. Defendants, however, did not challenge Smith's argument that fiduciary duty claims were not subject to the exhaustion requirement. App. 21-22. The district court accepted Defendant's argument and dismissed the suit for failure to exhaust. The Fourth Circuit reversed. Focusing on the allegations involving the fiduciaries' self-dealing and the derivative nature of the suit, the court found that the allegations stated cogent claims for breach of fiduciary duty under ERISA § 404 - § 406. In doing so, the court also ruled that fiduciary duty claims are not subject to the ERISA's exhaustion requirement.

Defendants argue that the Fourth Circuit's decision should be reversed because (i) Smith's claim is really one for benefits under an ERISA plan which must be exhausted, and (ii) the Fourth Circuit adopted the minority position in ruling that fiduciary duty claims under ERISA are not subject to exhaustion.[5] Defendants' arguments must be discarded. The Fourth Circuit wisely rejected Defendants' argument that the instant suit was a claim for benefits simply because Smith would indirectly benefit from its successful resolution. A claim for benefits under an ERISA plan does not arise every time an

[5] Defendants argue that the Fourth Circuit should have reviewed the district court's decision for abuse of discretion. Petition for Writ of Certiorari ("Petition") at 7. Even if this was the proper standard, Defendants raise this argument for the first time in their Petition and, for this reason alone, it should be rejected.

ERISA plaintiff may "benefit" from the claim's outcome. In addition, the cases cited by Defendants as opposing the Fourth Circuits' decision do not establish that the court adopted a minority position or that there is even a split in authority regarding the exhaustion of § 404 - § 406 claims. Moreover, these decisions involve classic benefits claims and, as such, are clearly distinguishable from the case at bar. Accordingly, Defendants' Petition should be denied.

A. The Fourth Circuit's Decision Should Not Be Disturbed

The primary issue before the Fourth Circuit was whether the instant suit stated a claim for benefits or for breach of fiduciary duty. The court correctly concluded that Smith alleged a pure claim for breach of fiduciary duty that did not have to be exhausted. There is no reason to disturb this decision.

There are three types of claims under ERISA: benefit claims, fiduciary duty claims and interference claims. Benefit claims arise out of the interpretation of an ERISA benefits plan. Fiduciary duty claims arise from conduct which violates ERISA § 404, § 405 or § 406. 29 U.S.C. §§ 1104-06. Interference claims arise out of ERISA § 510, which prohibits interference with the enjoyment of benefits under an ERISA plan. 29 U.S.C. § 1140. Claims for breach of fiduciary duty and violations of § 510 involve solely the interpretation and application of ERISA's statutory provisions. As such, they are called statutory claims.

ERISA does not explicitly require exhaustion of any claims. The exhaustion requirement is rooted in ERISA § 503. This section requires every ERISA covered plan to provide an internal review procedure for participants whose claims for benefits have been denied. 29 U.S.C. § 1133. Based on this requirement, courts have inferred that Congress intended for participants to use these procedures before filing their benefit

claims in federal court. See e.g., Fallick v. Nationwide Mutual Ins. Co., 162 F.3d 410, 418 n4 (3rd Cir. 1998) (extensive list of citations).

Significantly, § 503 does not require a review mechanism for statutory claims. See Zipf v. AT&T, 799 F.2d 889, 891-92 (3rd Cir. 1986). Consequently, the public policy factors supporting exhaustion in the context of benefit claims -- namely, utilizing the administrator's expertise in reviewing and interpreting the specific plan, and giving them the opportunity to correct any errors, and build a factual record for review -- simply do not apply to statutory claims. Exhaustion of statutory claims is not necessary to permit plan administrators to use their expertise to interpret plan provisions, build a factual record for review and correct their errors because statutory claims do not involve the interpretation of a plan. See Constantino, 13 F.3d at 975. Indeed, requiring exhaustion of statutory claims would abrogate the judiciary of one of its primary functions -- the interpretation and application of laws passed by Congress -- and result in the adjudication of a splintered body of law developed by different courts and plan administrators. See Amaro v. Continental Can Co., 724 F.2d 747, 751 (9th Cir. 1984).

In addition, exhaustion of § 404 - § 406 claims serves absolutely no purpose. Most benefit plans, like McGraw's, do not provide any procedure for filing fiduciary duty claims and cannot provide any relief against fiduciaries for their misconduct. Thus, plan administrators have no authority to issue a binding judgment against a fiduciary for financial or equitable relief. Exhaustion of statutory claims is, therefore, pointless. "The law does not require parties to engage in useless acts or to needlessly squander resources as a prerequisite to commencing litigation." Fallick, 162 F.2d at 420 (quoting Corsini v. United Healthcare Corp., 965 F. Supp. 265, 269-70 (D.R.I. 1997).

Seeking to circumvent this cogent authority, Defendants argue the Smith's suit should be treated as a benefits claim because Smith would financially benefit if his derivative claim is successful. The Fourth Circuit rejected this argument. "Although the remedy will undoubtedly benefit Smith and other participants in the Plan, it does not solely benefit the individual participants .... Any recovery against Sydnor and McGraw must be paid to the Plan and not to individual participants." App. 14-15.

Relying on a portion of this holding, Defendants argue:

> The Fourth Circuit determined Smith would undoubtedly recover a benefit as a result of prevailing on his claim for an alleged breach of fiduciary duty by the plan trustees. As such, regardless of the captions applied to the claims in his pleadings, his claim is properly construed as one to recover benefits under his ERISA regulated plan.

Petition at 9. Thus, Defendants believe that this action should be treated as a benefits claim because Smith would ultimately benefit by winning his derivative claim. This is the main premise in Defendants' Petition. It is also its fatal flaw.

A claim for benefits under an ERISA plan is not the same as receiving a "benefit" as used in the general sense. The distinction between benefit claims and the instant case illustrates this point. Benefit claims are filed by individuals to challenge an administrator's interpretation or implementation of a particular plan. However, Smith concedes that his retirement benefits were calculated and distributed correctly under the terms of the Plan. Smith instead challenges the fiduciaries' handling of the Plan's assets (i.e., the preferred stock). Smith filed this action as a derivative claim asserting that the fiduciaries undersold the Plan's preferred stock to reap

personal profits at the Plan's expense. Thus, even if he is successful, Smith cannot recover individually; all recovery must go directly to the Plan. See Massachusetts Mut. Life Ins. v. Russell, 473 U.S. 134, 146-47 (1985). To receive any "benefit," Smith must apply for supplemental retirement benefits after the award is placed in the Plan. Even though Smith may ultimately receive these "benefits," this by itself does mean that Smith's derivative claim should be treated, even partially, as a claim for benefits.

Defendants further ague that the instant claim is really one for benefits because " . . . Smith seeks to recover money damages on behalf of himself and other members of the putative class of plan participants." Petition at 7 n8. This is only partially correct. Smith actually filed this action " . . . for himself and all Plan participants similarly situated on behalf of the James McGraw Inc. 401(k) Plan." App. 1. (emphasis added). Thus, Smith is not seeking any individual benefit from the instant claim. He is solely exercising his right to sue on behalf of the Plan for the relief provided in § 409 of ERISA.

Accordingly, the Court must reject Defendants' attempts to transform the instant suit into a benefits claim. The Fourth Circuit properly rejected this position, decided that Smith's allegations stated a pure claim for breach of fiduciary duty and refused to apply the exhaustion requirement to Smith's claim. Defendants have failed to assert any cogent reason to disturb this result.

B. Defendant's Proposed "Majority" Rule Does Not Exist.

Defendants contend the First, Second, Fifth, Sixth, Seventh and Eleventh Circuits have adopted the so-called majority rule requiring exhaustion of ERISA statutory claims. Petition at 3. Defendants further contend the Fourth Circuit deviated from this majority by determining fiduciary duty claims are not subject to exhaustion. However, the cases

adopting the "majority" rule involved primarily the exhaustion of benefit claims. Consequently, Defendants' "majority" position does not exist.[6]

In Drinkwater v. Metro Life Ins. Co., 846 F.2d 821 (1st Cir. 1988), cert. denied, 488 U.S. 909 (1988), the First Circuit ordered exhaustion where a plan participant filed suit challenging the calculation of his disability benefits. The court wisely rejected the plaintiff's argument that any improper denial of benefits also constitutes a breach of fiduciary duty.

In Alfarone v. Bernie Wolff Constr. Corp., 788 F.2d 76 (2nd Cir. 1986), the Second Circuit applied exhaustion to a claim filed by union trustees to recover delinquent contributions to a union pension fund. The trustees had to proceed initially through arbitration because that process was provided for under the applicable collective bargaining agreement and plan documents.

In Simmons v. Wilcox, 911 F.2d 1077 (5th Cir. 1990), the Fifth Circuit ordered exhaustion where the employee claimed she was denied benefits under a health plan and that the fiduciaries wrongly withheld information regarding the status of her benefits. Id. at 1081. The Fifth Circuit found no merit to her claims for denial of information and dismissed the remaining claims because they were benefit claims which had not been exhausted.

The Sixth Circuit decision cited by the Defendants -- Constantino v. TRW, Inc., 13 F.3d 969 (6th Cir. 1994)-- involved a class action filed by retirees challenging the calculation of their early retirement benefits. Exhaustion did not apply because the plaintiffs challenged the legality of the particular plan amendment and not the administrator's interpretation of the plan.

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[6] Before the district court, Defendants did not challenge Smith's contention that the exhaustion requirement did not apply to fiduciary duty claims. App. 22.

In Lindemann v. Mobil Oil Corp., 79 F.3d 647 (7th Cir. 1996), the Seventh Circuit applied exhaustion to § 510 claim where the plaintiff claimed her termination was designed to interfere with her right to take sick days.

In Mason v. Continental Group, Inc., 763 F.2d 1219 (11th Cir. 1985), cert. denied, 474 U.S. 1087 (1986), the Eleventh Circuit to another § 510 claim where employees filed a class action alleging that their employer closed its plant and terminated plaintiffs' employment because it wanted to prevent the plaintiffs from attaining rights and benefits under a comprehensive benefit plan administered by the employer.[7]

As these decisions illustrate, Defendants' asserted majority position does not exist. The decisions from the First, Second, Fifth and Sixth Circuits clearly do not apply to the instant claim. They each involve classic benefit claims where a plan participant is challenging the calculation or denial of their benefits under an ERISA plan. None of these cases involve the allegations in the instant claim where a participant filed a derivative claim to challenge the treatment of the plan by the fiduciaries. Moreover, these decisions adhere to the approach adopted by the Fourth Circuit where benefit claims must be exhausted but fiduciary duty claims do not. Compare Makar v. Health-Care Corp., 872 F.2d 80, 82 (4th Cir. 1989) (participant challenging denial of benefits must exhaust internal plan remedies) with Smith v. Sydnor, 184 F.3d 356 (4th Cir. 1999) (claims for violations of § 404 - § 406 do not have to be exhausted). Accordingly, Defendants' reliance on these cases to form a "majority" position must be rejected.

Defendants' reliance on the Fifth and Sixth Circuit decisions -- Simmons and Constantino -- is further suspect because both these circuits decided in other cases not to apply exhaustion to statutory claims. See Chailland v. Brown &

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[7] In Mason, the employee asserted his § 404 and § 406 claims for the first time on appeal. 763 F.2d at 1225.

Root, Inc., 45 F.3d 947, 950-51 (5th Cir. 1995) (no exhaustion for § 510 claim because plan is incapable of providing a remedy); Richards v. General Motors Corp., 991 F.2d 1227, 1235 (6th Cir. 1993) (exhaustion not required for § 510 claims).

Defendants' "majority" position, therefore, amounts to the decisions in Lindemann and Mason. While both these decisions upheld the dismissal of § 510 claims for failure to exhaust internal plan remedies, they did not directly involve the exhaustion of § 404 - § 406 claims. Thus, even if this Court acknowledged the Fourth Circuit's decision is at odds with Lindemann and Mason, this Petition should still be denied because the instant claim is not the proper case to address this issue. To the extent any split exists on the exhaustion issue, it is between benefit claims and § 510 claims. Thus, a § 404 - § 406 claim, like the instant claim, is not the proper context in which to resolve this split. Accordingly, Defendants' Petition should be denied.

CONCLUSION

The Fourth Circuit's decision should not be disturbed. The court correctly determined that the instant suit was not a claim for benefits and that fiduciary duty claims under ERISA do not have to be exhausted. To overcome this decision, Defendants urge this Court to adopt a new rule requiring exhaustion of any ERISA claim which may ultimately benefit the claimant. Such a rule would turn every fiduciary duty claim into one for benefits and, as such, it must be rejected. Moreover, Defendants' attempt to create a "majority" rule requiring exhaustion of the instant claim must be rejected because this "majority" position simply does not exist.

Accordingly, Defendants' Petition should be denied.

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Respectfully submitted,

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